Dollars in millions except per share amounts

financial group. Balloting for presubscription of long-distance service is currently occurring among Telmex's customers in selected areas.

Other Business Matters

Merger Agreement On April 1, 1997, SBC and PAC completed the merger of an SBC subsidiary with PAC, in a transaction in which each share of PAC common stock was exchanged for 0.73145 of a share of SBC common stock. With the merger, PAC became a wholly-owned subsidiary of SBC. The transaction has been accounted for as a pooling of interests and a tax-free reorganization. Accordingly, the financial statements for the periods presented have been restated to include the accounts of PAC (see Note 3 to the financial statements for more information).

Restructuring Reserve In December 1993, a reserve was established to record the incremental cost of force reductions associated with restructuring PacBell's business processes through 1997. This restructuring was expected to allow PacBell to eliminate approximately 10,000 employee positions through 1997, net of approximately 4,000 new positions expected to be created. Net force reductions were 1,926 for 1996 and 9,168 for the three-year period 1994 through 1996. The pace of net force loss moderated in 1996 due to strong volume growth at PacBell.

This table sets forth the status and activity of this reserve.

	1996	1995	1994
Balance - beginning of year	$ 228	$ 819	$ 1,097
Additions	-	-	-
Charges: cash outlays	(195)	(372)	(216)
non-cash	64	(219)	(62)
Balance - end of year	$ 97	$ 228	$ 819

Charges to the restructuring reserve in 1996 totaled $131, including cash outlays of $195 and a $64 non-cash charge reversal described below. In 1995, PacBell charged $219 to the restructuring reserve for the non-cash cost through 1997 of enhanced retirement benefits negotiated in the 1995 union contracts, to be paid from pension fund assets. Based on its experience, in 1996 PacBell revised its estimate of these retirement costs. Consequently, $64 of these 1995 non-cash charges were reversed in 1996. There was no effect on net income from either the 1995 charge or the 1996 change in this estimate. Management expects to use the remaining reserve balance during 1997.

Effective with the merger, SBC has begun a complete review of all of its subsidiaries, including subsidiaries of PAC. Approximately 50 review teams are examining operational functions within the companies and evaluating all strategic initiatives. The teams will identify synergies between the companies, establish uniform system requirements and redirect strategic efforts. SBC cannot currently estimate the amount of future savings to be derived from this process or the amount of current and future costs associated with reorganizing functions and reevaluating strategies that SBC will incur; however, significant changes in strategic initiatives or combinations of common functions would result in material charges to SBC's 1997 results of operations. SBC anticipates the review teams will complete the evaluation phase by the end of the second quarter.

Acquisitions and Dispositions In addition to the acquisitions, dispositions and the merger of SBC's United Kingdom cable television operations discussed in Note 13 to the financial statements, SBC has made several acquisitions and dispositions since 1994.

In October 1994, SBC sold an additional 25% of its United Kingdom cable television operations to Cox Cable Communications, accounting for the remaining investment under the equity method of accounting until the 1995 merger of these operations.

In 1995, SBC made the following acquisitions: a wireless system serving Watertown, New York, and 100% of the stock of Cross Country Wireless (CCW), a wireless cable television operator providing service to 40,000 customers in Riverside, California and with licenses to provide service in Los Angeles, Orange County and San Diego. The CCW acquisition involved the exchange of approximately $120 of stock and assumption of $55 in debt. Additionally, SBC made the following equity investments in 1995: a $317 investment for 40% of VTR S.A. (VTR), a privately owned Chilean telecommunications holding company which is 51% owned by Grupo Luksic, a large Chilean conglomerate and an investment in a South African wireless company.

In 1996, SBC made the following additional investments: an investment to maintain its indirect 10% ownership in a French cellular company to offset dilution of its interest resulting from other equity sales, and an increase in its holding in VTR to 49% through the purchase of shares from another minority shareholder. Also in 1996, SBC and the other RHC's reached an agreement to sell Bell Communications Research (Bellcore) in a transaction expected to close in 1997.

In March 1997, the consortium of SBC and Telekom Malaysia Berhad, which is 60% owned by SBC, finalized an agreement to purchase 30% of Telkom South Africa (Telkom), the state-owned telecommunications company of South Africa. Under the agreement, SBC is committed to invest approximately $750, approximately $600 of which will remain in Telkom. The transaction is expected to close in the second quarter of 1997.

None of these transactions had a material effect on SBC's financial results in 1996, 1995 or 1994, nor does management expect them to have a material effect on SBC's financial position or results of operations in 1997.

Strategic Realignment In July 1995, SBC announced a strategic realignment which positions the company to be a single-source provider of telecommunications services. All of SBC's operations within the five-state area report to one management group, while international operations and domestic operations outside the five-state area report to a separate management group.

In connection with this realignment of functions, in 1995 SBC recognized $139 in selling, general and administrative expenses. These expenses include postemployment benefits for approximately 2,400 employees arising from the future consolidation of operations within the five-state area, streamlining support and administrative functions and integrating financial systems. Implementation of the realignment has been delayed due to the merger with PAC. The charge reduced net income for 1995 by approximately $88.

Management's Discussion and Analysis, continued

Dollars in millions except per share amounts

Liquidity and Capital Resources

Capital Expenditures and Other Commitments

To provide high-quality communications services to its customers, SBC, particularly the Telephone Companies, Mobile Systems and SBC's PCS operations must make significant investments in property, plant and equipment. The amount of capital investment is influenced by demand for services and products, continued growth and regulatory commitments.

SBC's capital expenditures totaled $5,481, $4,338 and $3,981 for 1996, 1995 and 1994. The Telephone Companies' capital expenditures increased 29% in 1996 and 11% in 1995 due primarily to demand-related growth, network upgrades, customer-contracted requirements, ISDN projects, PCS build-out and SWBell's regulatory commitments. SBC's capital expenditures increase in 1995 was also due to PAC's expenditures for the PCS network. Mobile Systems expenditures increased 10% in 1996 and 6% in 1995 due to continued growth.

In 1997, management expects total capital spending to increase from 1996, to between $5,800 and $6,000. Capital expenditures in 1997 will relate primarily to the continued evolution of the Telephone Companies' networks, including amounts agreed to under regulation plans at SWBell, and continued build out of Mobile Systems' markets and PAC's PCS. SBC expects to fund ongoing capital expenditures with cash provided by operations.

SWBell continues to make additional network and infrastructure improvements over periods ranging through 2001 to satisfy regulatory commitments. Total capital expenditures under these commitments will vary based on actual demand of potential end users. SWBell anticipates spending approximately $150 to $200 in 1997 associated with these commitments.

PacBell has purchase commitments of approximately $208 remaining in connection with its previously announced program for deploying an all-digital switching platform with ISDN and SS-7 capabilities.

In December 1994, PacBell contracted for the purchase of up to $2,000 in Advanced Communications Network (ACN) facilities, which incorporated new technologies. During 1995, the ability to deploy the facilities outstripped the ACN vendor's ability to deliver necessary products and software. Accordingly, management decided to suspend construction at certain sites, which reduced the expected cost to less than $700. If ACN facilities meet certain quality and performance criteria (the Network Test), PacBell is committed to purchase the ACN facilities in 1998. If ACN facilities are acquired, due to competition or other factors affecting PacBell's ability to recover its investment in these facilities, their value to PacBell could be materially impaired. If ACN facilities fail the Network Test, PacBell will not be committed to buy the ACN facilities but might be liable to reimburse the principal ACN vendor for some construction costs up to $300, which would also result in a material charge.

As discussed in Other Business Matters, SBC has committed to invest approximately $750 under its agreement to purchase a stake in Telkom South Africa. The transaction is expected to be completed in the second quarter of 1997.

Over the next few years, SBC is expecting to incur significant software expenditures for interconnection and customer number portability. The extent and timing of these expenditures will vary depending on the timing and nature of regulatory actions and corresponding or compensating network improvements, but are likely to be material.

Dollars in millions except per share amounts

Dividends Declared

Dividends declared by the Board of Directors of SBC were $1.72 per share in 1996, $1.65 per share in 1995, and $1.58 per share in 1994. These per share amounts do not include dividends declared and paid by PAC prior to the merger. Including those PAC dividends, total dividends paid were $1,680 in 1996, $1,933 in 1995 and $1,878 in 1994. Pursuant to the terms of the merger agreement, PAC reduced its 1996 second, third and fourth quarter dividends. The lower second and third quarter dividends paid in 1996 improved 1996 cash flow by approximately $195. Management's dividend policy considers both the expectations and requirements of shareowners, internal requirements of SBC and long-term growth opportunities.

Cash, Lines of Credit and Cash Flows

SBC had $314 of cash and cash equivalents available at December 31, 1996. Commercial paper borrowings as of December 31, 1996, totaled $1,848. SBC has entered into agreements with several banks for lines of credit totaling $3,550 all of which may be used to support commercial paper borrowings (see Note 6 to the Financial Statements). SBC had no borrowings outstanding under these lines of credit as of December 31, 1996.

During 1996, as in 1995 and 1994, SBC's primary source of funds continued to be cash generated from operations, as shown in the Consolidated Statements of Cash Flows. Net cash provided by operating activities exceeded SBC's construction and capital expenditures during 1996, as in 1995 and 1994; this excess is referred to as free cash flow, a supplemental measure of liquidity. SBC generated free cash flow of $1,935, $2,452 and $2,952 in 1996, 1995 and 1994.

During 1996 PAC issued $1,000 of TOPrS, $500 at 7.56% in January 1996 and $500 at 8.5% in June 1996 (see Note 7 to the financial statements). The proceeds were used to retire outstanding short-term debt, primarily commercial paper which had increased significantly during 1995.

During 1996 and 1995, the Telephone Companies refinanced long-term debt with an aggregate principal amount of $964.

Total Capital

SBC's total capital consists of debt (long-term debt and debt maturing within one year), TOPrS and shareowners' equity. Total capital increased $1,844 in 1996 and decreased $4,006 in 1995. The increase in 1996 was due to PAC's increased financing requirements and the reinvestment of earnings, partially offset by the acquisition of treasury shares. The decrease in 1995 was due to the effects of the discontinuance of regulatory accounting. Absent this extraordinary charge, total capital increased by $2,016 in 1995 due primarily to the reinvestment of earnings and increased commercial paper borrowings, partially offset by foreign currency translation adjustments resulting from the decline in the value of the Mexican peso.

Debt Ratio

SBC's debt ratio was 55.5%, 61.7% and 48.6% at December 31, 1996, 1995 and 1994. The debt ratio is affected by the same factors that affect total capital. For 1995, the decrease in equity caused by the discontinuance of regulatory accounting increased the debt ratio by 13.2 percentage points.

Share Repurchases

See Note 12 to the financial statements.

Employee Stock Ownership Plans

See Note 10 to the financial statements.

Report of Independent Auditors

The Board of Directors and Shareowners
SBC Communications Inc.

We have audited the accompanying supplemental consolidated balance sheets of SBC Communications Inc. (formed as a result of the consolidation of SBC Communications Inc. (SBC) and Pacific Telesis Group (PAC)) as of December 31, 1996 and 1995, and the related supplemental consolidated statements of income, shareowners' equity and cash flows for each of the three years in the period ended December 31, 1996. The supplemental consolidated financial statements give retroactive effect to the merger of SBC and PAC on April 1, 1997, which has been accounted for using the pooling of interests method as described in the notes to the supplemental consolidated financial statements. These supplemental consolidated financial statements are the responsibility of SBC's management. Our responsibility is to express an opinion on these supplemental consolidated financial statements based on our audits. We did not audit the financial statements of PAC which statements reflect total assets constituting 42% for 1996 and 43% for 1995 of the related supplemental consolidated financial statement totals, and which reflect total operating revenues constituting approximately 41%, 42% and 44% of the related supplemental consolidated financial statement totals for the years ended December 31, 1996, 1995 and 1994. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to data included for PAC, is based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the supplemental consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SBC Communications Inc. at December 31, 1996 and 1995, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1996, after giving retroactive effect to the merger of PAC, as described in Note 3 to the supplemental consolidated financial statements, in conformity with generally accepted accounting principles.

As discussed in Note 3, the supplemental consolidated financial statements include the effects of changes applied retroactively to conform accounting methodologies between PAC and SBC. As discussed in Note 1 to the supplemental consolidated financial statements, Pacific Bell, a subsidiary of PAC, changed its method of recognizing directory publishing revenues and related expenses effective January 1, 1996. As discussed in Note 2 to the supplemental consolidated financial statements, SBC discontinued its application of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" in 1995.

ERNST & YOUNG LLP

San Antonio, Texas
February 14, 1997,
except for Note 3, as to which the date is
April 1, 1997

SBC Communications Inc.
Consolidated Statements of Income

Dollars in millions except per share amounts

	1996	1995	1994
Operating Revenues			
Local service	**$ 11,430**	$ 10,365	$ 9,243
Network access	**5,831**	5,514	5,204
Long-distance service	**2,240**	2,072	2,923
Directory advertising	**1,985**	1,984	1,950
Other	**2,000**	1,777	1,686
Total operating revenues	**23,486**	21,712	21,006
Operating Expenses			
Cost of services and products	**8,220**	7,864	7,917
Selling, general and administrative	**5,321**	4,694	4,315
Depreciation and amortization	**4,109**	4,034	3,824
Total operating expenses	**17,650**	16,592	16,056
Operating Income	**5,836**	5,120	4,950
Other Income (Expense)			
Interest expense	**(812)**	(957)	(935)
Equity in net income of affiliates	**207**	120	226
Other income (expense) - net	**(82)**	194	(16)
Total other income (expense)	**(687)**	(643)	(725)
Income From Continuing Operations Before Income Taxes, Extraordinary Loss and Cumulative Effect of Accounting Change	**5,149**	4,477	4,225
Income taxes	**1,960**	1,519	1,448
Income from Continuing Operations	**3,189**	2,958	2,777
Income from spun-off operations, net of tax	**-**	-	23
Income Before Extraordinary Loss and Cumulative Effect of Accounting Change	**3,189**	2,958	2,800
Extraordinary Loss from Discontinuance of Regulatory Accounting, net of tax	**-**	(6,022)	-
Cumulative Effect of Accounting Change, net of tax	**90**	-	-
Net Income (Loss)	**$ 3,279**	$ (3,064)	$ 2,800
Earnings Per Common Share:			
Income from Continuing Operations	**$ 3.46**	$ 3.22	$ 3.04
Income from spun-off operations	**-**	-	.03
Income Before Extraordinary Loss and Cumulative Effect of Accounting Change	**3.46**	3.22	3.07
Extraordinary Loss	**-**	(6.55)	-
Cumulative Effect of Accounting Change	**.10**	-	-
Net Income (Loss)	**$ 3.56**	$ (3.33)	$ 3.07
Weighted Average Number of Common Shares Outstanding (in millions)	**921**	920	912

The accompanying notes are an integral part of the consolidated financial statements.

SBC Communications Inc.
Consolidated Balance Sheets

Dollars in millions except per share amounts

	December 31, 1996	December 31, 1995
Assets		
Current Assets		
Cash and cash equivalents	$ 314	$ 566
Short-term cash investments	432	243
Accounts receivable - net of allowances for uncollectibles of $311 and $266	4,684	3,995
Prepaid expenses	287	198
Deferred charges	102	369
Other current assets	452	666
Total current assets	6,271	6,037
Property, Plant and Equipment - Net	26,080	24,374
Intangible Assets - Net of Accumulated Amortization of $611 and $543	3,589	3,635
Investments in Equity Affiliates	1,964	1,616
Other Assets	1,581	1,450
Total Assets	$ 39,485	$ 37,112

The accompanying notes are an integral part of the consolidated financial statements.

SBC Communications Inc.
Consolidated Balance Sheets

Dollars in millions except per share amounts

	December 31, 1996	1995
Liabilities and Shareowners' Equity		
Current Liabilities		
Debt maturing within one year	**$ 2,335**	$ 3,210
Accounts payable and accrued liabilities	**6,584**	6,026
Dividends payable	**393**	484
Total current liabilities	**9,312**	9,720
Long-Term Debt	**10,930**	10,409
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	**853**	447
Postemployment benefit obligation	**5,070**	5,202
Unamortized investment tax credits	**498**	578
Other noncurrent liabilities	**2,181**	2,313
Total deferred credits and other noncurrent liabilities	**8,602**	8,540
Commitments and contingencies		
Corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts*	**1,000**	-
Shareowners' Equity		
Preferred shares ($1 par value, 10,000,000 authorized: none issued)	-	-
Common shares ($1 par value, 2,200,000,000 authorized: issued 933,772,624 at December 31, 1996 and 933,861,842 at December 31, 1995)	**934**	934
Capital in excess of par value	**9,422**	9,398
Retained earnings (deficit)	**1,297**	(316)
Guaranteed obligations of employee stock ownership plans	**(229)**	(272)
Deferred Compensation - LESOP trust	**(161)**	(242)
Foreign currency translation adjustment	**(637)**	(578)
Treasury shares (20,616,939 at December 31, 1996 and 11,122,981 at December 31, 1995, at cost)	**(985)**	(481)
Total shareowners' equity	**9,641**	8,443
Total Liabilities and Shareowners' Equity	**$ 39,485**	$ 37,112

* The trusts contain assets of $1,030 in principal amount of the Subordinated Debentures of Pacific Telesis Group.

The accompanying notes are an integral part of the consolidated financial statements.

SBC Communications Inc.
Consolidated Statements of Cash Flows
Dollars in millions, increase (decrease) in cash and cash equivalents

	1996	1995	1994
Operating Activities			
Net income (loss)	$ 3,279	$ (3,064)	$ 2,800
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	4,109	4,034	3,824
Undistributed earnings from investments in equity affiliates	(138)	(58)	(134)
Provision for uncollectible accounts	395	346	305
Amortization of investment tax credits	(80)	(95)	(124)
Deferred income tax expense	626	609	(20)
Extraordinary loss, net of tax	-	6,022	-
Cumulative effect of accounting change, net of tax	(90)	-	-
Spun-off operations	-	-	(23)
Changes in operating assets and liabilities:			
Accounts receivable	(765)	(463)	(493)
Other current assets	(50)	77	(97)
Accounts payable and accrued liabilities	632	(76)	556
Other - net	(502)	(542)	321
Total adjustments	4,137	9,854	4,115
Net Cash Provided by Continuing Operations	7,416	6,790	6,915
Net Cash Provided by Spun-off Operations	-	-	18
Net Cash Provided by Operating Activities	7,416	6,790	6,933
Investing Activities			
Construction and capital expenditures	(5,481)	(4,338)	(3,981)
Investments in affiliates	(74)	(54)	(25)
Purchase of short-term investments	(1,005)	(704)	(325)
Proceeds from short-term investments	816	587	390
Dispositions	96	14	296
Acquisitions	(442)	(1,186)	(1,238)
Net investment in spun-off operations	-	-	33
Net Cash Used in Continuing Operations	(6,090)	(5,681)	(4,850)
Net Cash used in spun-off operations	-	-	(332)
Net Cash Used in Investing Activities	(6,090)	(5,681)	(5,182)

The accompanying notes are an integral part of the consolidated financial statements.

SBC Communications Inc.
Consolidated Statements of Cash Flows
Dollars in millions, increase (decrease) in cash and cash equivalents

	1996	1995	1994
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	(977)	1,402	(129)
Issuance of other short-term borrowings	209	91	36
Repayment of other short-term borrowings	(134)	(91)	(41)
Issuance of long-term debt	989	981	355
Repayment of long-term debt	(408)	(1,086)	(462)
Early extinguishment of debt and related call premiums	-	(465)	-
Issuance of trust originated preferred securities	1,000	-	-
Issuance of common shares	111	74	180
Purchase of treasury shares	(650)	(216)	(447)
Issuance of treasury shares	52	82	18
Dividends paid	(1,664)	(1,814)	(1,744)
Other	(106)	-	(18)
Net Cash Used in Continuing Operations	(1,578)	(1,042)	(2,252)
Net cash provided by spun-off operations	-	-	39
Net Cash Used in Financing Activities	(1,578)	(1,042)	(2,213)
Net Cash Provided by (Used in) all Activities	(252)	67	(462)
Less spun-off operations	-	-	(275)
Net increase (decrease) in cash and cash equivalents	(252)	67	(187)
Cash and cash equivalents beginning of year	566	499	686
Cash and Cash Equivalents End of Year	$ 314	$ 566	$ 499

The accompanying notes are an integral part of the consolidated financial statements.

SBC Communications Inc.

Consolidated Statements of Shareowners' Equity

Dollars in millions except per share amounts

	Common Shares		Capital in Excess of Par Value	Retained Earnings (Deficit)	Guaranteed Obligations of Employee Stock Ownership Plans	Deferred Compensation Leveraged Employee Stock Ownership Trust	Foreign Currency Translation Adjustment	Treasury Shares		Total
	Shares	Amount						Shares	Amount	
Balance, December 31, 1993	912,191,021	$912	$11,400	$3,757	$(353)	$(386)	$(39)	(2,510,404)	$(110)	$15,181
Net income for the year ($3.07 per share)	-	-	-	2,800	-	-	-	-	-	
Dividends to shareowners ($1.58 per share)	-	-	-	(1,878)	-	-	-	-	-	
Spun-off stock distribution	-	-	(2,901)	-	-	-	-	-	-	
Reduction of debt associated with Employee Stock Ownership Plans	-	-	-	-	38	-	-	-	-	
Cost of LESOP trust shares allocated to employee accounts	-	-	-	-	-	80	-	-	-	
Foreign currency translation adjustment, net of income tax benefit of $197	-	-	-	-	-	-	(324)	-	-	
Issuance of common shares:										
Dividend Reinvestment Plan	3,334,668	4	134	-	-	-	-	-	-	
Other issuances	15,140,077	15	621	-	-	-	-	-	-	
Purchase of treasury shares	-	-	-	-	-	-	-	(11,301,550)	(447)	
Issuance of treasury shares	-	-	4	-	-	-	-	2,410,326	94	
Other	-	-	-	(14)	-	-	-	-	-	
Balance, December 31, 1994	930,665,766	931	9,258	4,665	(315)	(306)	(363)	(11,401,628)	(463)	13,407
Net income (loss) for the year ($(3.33) per share)	-	-	-	(3,064)	-	-	-	-	-	
Dividends to shareowners ($1.65 per share)	-	-	-	(1,933)	-	-	-	-	-	
Reduction of debt associated with Employee Stock Ownership Plans	-	-	-	-	43	-	-	-	-	
Cost of LESOP trust shares allocated to employee accounts	-	-	-	-	-	64	-	-	-	
Foreign currency translation adjustment, net of income tax benefit of $116	-	-	-	-	-	-	(215)	-	-	
Issuances of common shares	3,196,076	3	129	-	-	-	-	-	-	
Purchase of treasury shares	-	-	-	-	-	-	-	(4,610,713)	(216)	
Issuance of treasury shares:										
Dividend Reinvestment Plan	-	-	19	-	-	-	-	2,730,666	111	
Other issuances	-	-	(8)	-	-	-	-	2,158,694	87	
Other	-	-	-	16	-	-	-	-	-	
Balance, December 31, 1995	933,861,842	934	9,398	(316)	(272)	(242)	(578)	(11,122,981)	(481)	8,443
Net income for the year ($3.56 per share)	-	-	-	3,279	-	-	-	-	-	
Dividends to shareowners ($1.72 per share)	-	-	-	(1,680)	-	-	-	-	-	
Reduction of debt associated with Employee Stock Ownership Plans	-	-	-	-	43	-	-	-	-	
Cost of LESOP trust shares allocated to employee accounts	-	-	-	-	-	81	-	-	-	
Foreign currency translation adjustment, net of income tax benefit of $28	-	-	-	-	-	-	(59)	-	-	
Purchases of common shares	(89,218)	-	-	-	-	-	-	-	-	
Purchase of treasury shares	-	-	-	-	-	-	-	(13,099,709)	(650)	
Issuance of treasury shares:										
Dividend Reinvestment Plan	-	-	26	-	-	-	-	2,667,752	109	
Other issuances	-	-	(5)	-	-	-	-	937,999	37	
Other	-	-	3	14	-	-	-	-	-	
Balance, December 31, 1996	**933,772,624**	**$934**	**$9,422**	**$1,297**	**$(229)**	**$(161)**	**$(637)**	**(28,616,939)**	**$(985)**	**$9,641**

The accompanying notes are an integral part of the consolidated financial statements.

Notes to Consolidated Financial Statements

Dollars in millions except per share amounts

1. Summary of Significant Accounting Policies

Basis of Presentation - The consolidated financial statements include the accounts of SBC Communications Inc. and its majority-owned subsidiaries (SBC). SBC's subsidiaries and affiliates operate predominantly in the communications services industry, providing landline and wireless telecommunications services and equipment, directory advertising and cable television services both domestically and worldwide.

SBC's largest subsidiaries are Southwestern Bell Telephone Company (SWBell) providing telecommunications services in Texas, Missouri, Oklahoma, Kansas and Arkansas (five-state area), and Pacific Telesis Group (PAC), providing telecommunications services in California and Nevada. PAC's subsidiaries include Pacific Bell (PacBell, which also includes its subsidiaries) and Nevada Bell. (SWBell, PacBell and Nevada Bell are collectively referred to as the Telephone Companies.)

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships, joint ventures and less than majority-owned subsidiaries are principally accounted for under the equity method. Earnings from certain foreign investments accounted for under the equity method are included for periods ended within three months of SBC's year end.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Income Taxes - Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Investment tax credits earned prior to their repeal by the Tax Reform Act of 1986 are amortized as reductions in income tax expense over the lives of the assets which gave rise to the credits.

Cash Equivalents - Cash equivalents include all highly liquid investments with original maturities of three months or less.

Deferred Charges - Directory advertising costs are deferred until the directory is published and advertising revenues related to these costs are recognized.

Cumulative Effect of Accounting Change - Prior to January 1, 1996, Pacific Bell Directory (a subsidiary of PacBell) recognized revenues and expenses related to publishing directories in California using the "amortization" method, under which revenues and expenses were recognized over the lives of the directories, generally one year. The change in methodology was made because it is the method generally followed in the publishing industry, including Southwestern Bell Yellow Pages, and better reflects the operating activity of the business.

The cumulative after-tax effect of applying the change in method to prior years is recognized as of January 1, 1996 as a one-time, non-cash gain applicable to continuing operations of $90, or $0.10 per share. The gain is net of deferred taxes of $53. Had the current method been applied during 1995 and 1994, income before extraordinary loss and accounting change would not have been materially affected.

Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

Property, Plant and Equipment - Property, plant and equipment is stated at cost. The cost of additions and substantial betterments of property, plant and equipment is capitalized. The cost of maintenance and repairs of property, plant and equipment is charged to operating expenses. Property, plant and equipment is depreciated using straight-line methods over their estimated economic lives, generally ranging from 3 to 50 years. Prior to the discontinuance of regulatory accounting in the third quarter of 1995, SWBell and PacBell computed depreciation using certain straight-line methods and rates as prescribed by regulators. In accordance with composite group depreciation methodology, when a portion of the Telephone Companies' depreciable property, plant and equipment is retired in the ordinary course of business, the gross book value is charged to accumulated depreciation; no gain or loss is recognized on the disposition of this plant.

Intangible Assets - Intangible assets consist primarily of wireless cellular, PCS and television licenses, cable television licenses, customer lists and the excess of consideration paid over net assets acquired in business combinations. These assets are being amortized using the straight-line method, over periods generally ranging from 5 to 40 years. At December 31, 1996 and 1995, amounts included in net intangible assets for licenses were $2,695 and $2,692. Management periodically reviews the carrying value and lives of all intangible assets based on expected future cash flows.

Software Costs - The costs of computer software purchased or developed for internal use are expensed as incurred. However, initial operating system software costs are capitalized and amortized over the lives of the associated hardware.

Advertising Costs - Costs for advertising products and services or corporate image are expensed as incurred.

Foreign Currency Translation - Local currencies are generally considered the functional currency for SBC's share of foreign operations, except in countries considered highly inflationary. SBC translates its share of foreign assets and liabilities at current exchange rates. Revenues and expenses are translated using average rates during the year. The ensuing foreign currency translation adjustments are recorded as a separate component of Shareowners' Equity. Other transaction gains and losses resulting from exchange rate changes on transactions denominated in a currency other than the local currency are included in earnings as incurred.

Earnings Per Common Share - The earnings per common share computation uses the weighted average number of common shares outstanding, including shares held by employee stock ownership plans. Common stock equivalents outstanding are not considered dilutive.

2. Discontinuance of Regulatory Accounting

In the third quarter of 1995, SWBell and PacBell discontinued their application of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (FAS 71). FAS 71 requires depreciation of telephone plant using lives set by regulators which are generally longer than those established by unregulated companies, and deferral of certain costs and obligations based on regulatory actions (regulatory assets and liabilities). As a result of the adoption of price-based regulation for most of SWBell's revenues and the acceleration of competition in the California and five-state area telecommunications markets, management determined that SWBell and PacBell no longer met the criteria for application of FAS 71.

Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

Upon discontinuance of FAS 71 by SWBell and PacBell, SBC recorded a non-cash, extraordinary charge to net income of $6,022 (after a net deferred tax benefit of $4,037). This charge was comprised of an after-tax charge of $5,739 to reduce the net carrying value of telephone plant, and an after-tax charge of $283 for the elimination of net regulatory assets. The components of the charge were as follows:

	Pre-tax	After-tax
Increase telephone plant accumulated depreciation	$ 9,476	$ 5,739
Elimination of net regulatory assets	583	283
Total	$ 10,059	$ 6,022

The increase in accumulated depreciation of $9,476 reflected the effects of adopting depreciable lives for SWBell's and PacBell's plant categories which more closely reflect the economic and technological lives of the plant. The adjustment was supported by discounted cash flow analyses which estimated amounts of telephone plant that may not be recoverable from discounted future cash flows. These analyses included consideration of the effects of anticipated competition and technological changes on plant lives and revenues.

Following is a comparison of new lives to those prescribed by regulators for selected plant categories:

	Average Lives (in Years)	
	Regulator-Prescribed	Estimated Economic
Digital switch	17	10-11
Digital circuit	10-12	7-8
Copper cable	19-26	14-18
Fiber cable	27-30	20
Conduit	57-59	50

The increase in accumulated depreciation at SWBell also included an adjustment of approximately $450 to fully depreciate analog switching equipment scheduled for replacement. Remaining analog switching equipment is being depreciated using an average remaining life of four years.

The discontinuance of FAS 71 for external financial reporting purposes also required the elimination of net regulatory assets of $583. Regulatory assets and liabilities are related primarily to accounting policies used by regulators in the ratemaking process which are different from those used by non-regulated companies. The differences arose predominantly in the accounting for income taxes, deferred compensated absences, and, in California, pension costs and debt redemption costs. These items are required to be eliminated with the discontinuance of accounting under FAS 71. SWBell and PacBell accounting and reporting for regulatory purposes are not affected by the discontinuance of FAS 71 for external financial reporting purposes.

With the discontinuance of FAS 71, SWBell and PacBell began accounting for interest on funds borrowed to finance construction as an increase in property, plant and equipment and a reduction of interest expense. Under the provisions of FAS 71, both companies capitalized both interest and equity costs allowed by regulators during periods of construction as other income and as an addition to the cost of plant constructed. Additionally, PacBell began accounting for pension costs under Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," (FAS 87) and Statement of Financial Accounting Standards No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" (FAS 88).

Dollars in millions except per share amounts

3. Merger Agreement

On April 1, 1997, SBC and PAC completed the merger of an SBC subsidiary with PAC, in a transaction in which each share of PAC common stock was exchanged for 0.73145 of a share of SBC common stock (equivalent to approximately 313 million shares). With the merger, PAC became a wholly-owned subsidiary of SBC. The transaction has been accounted for as a pooling of interests and a tax-free reorganization. Accordingly, the financial statements for the periods presented have been restated to include the accounts of PAC. These are supplemental consolidated financial statements which will become the historical consolidated financial statements of SBC upon issuance of financial statements for the quarter ending June 30, 1997.

Operating revenues, income before extraordinary loss and cumulative effect of accounting change and net income (loss) of the separate companies for the last three years were as follows:

Year Ended December 31,	1996	1995	1994
Operating revenues:			
SBC	$ 13,898	$ 12,670	11,772
PAC	9,588	9,042	9,234
Combined	$ 23,486	$ 21,712	$ 21,006
Income before extraordinary loss and cumulative effect of accounting change:			
SBC	$ 2,101	$ 1,889	$ 1,649
PAC	1,057	1,048	1,159
Adjustments	31	21	(8)
Combined	$ 3,189	$ 2,958	$ 2,800
Net income (loss):			
SBC	$ 2,101	$ (930)	$ 1,649
PAC	1,142	(2,312)	1,159
Adjustments	36	178	(8)
Combined	$ 3,279	$ (3,064)	$ 2,800

The combined results include the effect of changes applied retroactively to conform accounting methodologies between PAC and SBC for, among other items, pensions, postretirement benefits, sales commissions and merger transaction costs as well as certain deferred tax adjustments resulting from the merger. In each case, SBC believes the new methods are more prevalent and better reflect the operations of the business. Transaction costs and one-time charges relating to the closing of the merger were $359 ($215 net of tax) including, among other items, the present value of amounts to be returned to California ratepayers as a condition of the merger and expenses for investment banker and professional fees. Of this amount, $72 is included in expenses in 1996. The remainder will be reflected in 1997 expenses.

Effective with the merger, SBC has begun a complete review of all of its subsidiaries, including subsidiaries of PAC. Approximately 50 review teams are examining operational functions within the companies and evaluating all strategic initiatives. The teams will identify synergies between the companies, establish uniform system requirements and redirect strategic efforts. SBC cannot currently estimate the amount of future savings to be derived from this process or the amount of current and future costs associated with reorganizing functions and reevaluating strategies that SBC will incur; however, significant changes in strategic initiatives or combinations of common functions would result in material charges to SBC's 1997 results of operations. SBC anticipates the review teams will complete the evaluation phase by the end of the second quarter.

Dollars in millions except per share amounts

4. Property, Plant and Equipment

Property, plant and equipment is summarized as follows at December 31:

	1996	1995
Telephone Companies plant		
In service	$ 56,638	$ 54,152
Under construction	1,614	1,042
	58,252	55,194
Accumulated depreciation and amortization	(34,515)	(32,698)
Total Telephone Companies	23,737	22,496
Other	3,534	2,819
Accumulated depreciation and amortization	(1,191)	(941)
Total other	2,343	1,878
Property, plant and equipment--net	$ 26,080	$ 24,374

SBC's depreciation expense as a percentage of average depreciable plant was 7.2% for 1996, 7.4% for 1995, and 7.2% for 1994.

Certain facilities and equipment used in operations are under operating or capital leases. Rental expenses under operating leases for 1996, 1995 and 1994 were $207, $166 and $159. At December 31, 1996, the future minimum rental payments under noncancelable operating leases for the years 1997 through 2001 were $124, $109, $103, $57 and $35, and $180 thereafter. Capital leases were not significant.

Dollars in millions except per share amounts

5. Equity Investments

Investments in affiliates accounted for under the equity method consist principally of SBC's investment in Teléfonos de México, S.A. de C.V. (Telmex), Mexico's national telecommunications company. SBC is a member of a consortium that holds all of the AA shares of Telmex stock, representing voting control of the company. The consortium is controlled by a group of Mexican investors led by an affiliate of Grupo Carso, S.A. de C.V. SBC also owns L shares which have limited voting rights. In January 1997, SBC sold a portion of its L shares so that its total equity investment was below 10% of Telmex's total equity capitalization.

In December 1994 SBC made an equity investment in French cellular operations (see Note 12). Other equity investments held by SBC include interests in Australian and Israeli operations which provide directory, cable television and other services, minority ownership of several domestic wireless properties and 1995 investments in Chilean telecommunications and South African wireless operations.

The following table is a reconciliation of SBC's investments in equity affiliates:

	1996	1995	1994
Beginning of year	$ 1,616	$ 1,776	$ 1,458
Additional investments	337	447	629
Equity in net income	207	120	224
Dividends received	(70)	(62)	(90)
Currency translation adjustment	(94)	(268)	(560)
Reclassifications and other adjustments	(32)	(397)	115
End of year	$ 1,964	$ 1,616	$ 1,776

Currency translation adjustments for 1995 and 1994 primarily reflect the effect on SBC's investment in Telmex of the decline in the value of the Mexican peso relative to the U.S. dollar during those years. Beginning in 1997, SBC will use the U.S. dollar, instead of the peso, as the functional currency for its investment in Telmex due to the Mexican economy becoming highly inflationary.

Other adjustments for 1995 reflect the change to the cost method of accounting in October 1995 for SBC's United Kingdom cable television operations (see Note 13) and the reclassification of a credit deferred in 1994 pending completion of the French cellular investment in 1995. Other adjustments for 1994 reflect the change to the equity method of accounting for SBC's previously consolidated United Kingdom cable television operations.

Undistributed earnings from equity affiliates were $762 and $624 at December 31, 1996 and 1995.

Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

6. Debt

Long-term debt, including interest rates and maturities, is summarized as follows at December 31:

		1996	1995
SWBell			
Debentures			
4.50%-5.88%	1997-2006	$ 600	$ 600
6.12%-6.88%	2000-2024	1,200	1,200
7.00%-7.75%	2009-2026	1,500	1,500
8.30%	1996	-	200
		3,300	3,500
Unamortized discount--net of premium		(29)	(31)
Total debentures		3,271	3,469
Notes			
5.04%-7.67%	1997-2010	1,118	950
Unamortized discount		(6)	(5)
Total notes		1,112	945
PacBell			
Debentures			
4.62%-5.88%	1999-2006	475	225
6.00%-6.88%	2002-2034	1,194	945
7.12%-7.75%	2008-2043	2,150	2,150
8.50%	2031	225	225
		4,044	3,545
Unamortized discount--net of premium		(89)	(85)
Total debentures		3,955	3,460
Notes			
6.25%-8.70%	2001-2005	1,150	1,150
Unamortized discount		(18)	(20)
Total notes		1,132	1,130
Other notes			
5.70%-6.98%	1996-2007	310	316
7.00%-9.50%	1996-2020	1,140	1,263
		1,450	1,579
Unamortized discount		(14)	(21)
Total other notes		1,436	1,558
Guaranteed obligations of employee stock ownership plans [(1)]			
8.41%-9.40%	1996-2000	208	260
Capitalized leases		303	48
Total long-term debt, including current maturities		11,417	10,870
Current maturities		(487)	(461)
Total long-term debt		$ 10,930	$ 10,409

[(1)] See Note 9.

During 1995, SBC refinanced long-term debentures of SWBell and PacBell. Costs of $36 associated with refinancing are included in other income (expense) - net, with related income tax benefits of $14 included in income taxes in SBC's Consolidated Statements of Income.

Dollars in millions except per share amounts

At December 31, 1996, the aggregate principal amounts of long-term debt scheduled for repayment for the years 1997 through 2001 were $487, $347, $582, $485 and $509. As of December 31, 1996, SBC was in compliance with all covenants and conditions of instruments governing its debt.

During 1996, PAC entered into sale and leaseback arrangements to finance equipment associated with the buildout of its PCS network. As of December 31, 1996 the obligation remaining for this group of leases is $270. These leases are classified as capitalized leases and the related assets are classified as property, plant and equipment.

Debt maturing within one year consists of the following at December 31:

	1996	1995
Commercial paper	$ 1,848	$ 2,749
Current maturities of long-term debt	487	461
Total	$ 2,335	$ 3,210

The weighted average interest rate on commercial paper debt at December 31, 1996 and 1995 was 6.0% and 5.8%. SBC has entered into agreements with several banks for lines of credit totaling $750. All of these agreements may be used to support commercial paper borrowings and are on a negotiated fee basis with interest rates negotiable at time of borrowing. There were no borrowings outstanding under these lines of credit at December 31, 1996. Another group of uncommitted lines of credit with banks that do not require compensating balances or commitment fees, and accordingly are subject to continued review, amounted to approximately $2,800 at December 31, 1996.

7. Financial Instruments

The carrying amounts and estimated fair values of SBC's long-term debt, including current maturities and other financial instruments, are summarized as follows at December 31:

	1996		1995	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
SWBell debentures	$3,271	$3,208	$3,469	$3,553
SWBell notes	1,112	1,115	945	965
PacBell debentures	3,955	3,917	3,460	3,651
PacBell notes	1,132	1,171	1,130	1,224
Other notes	1,436	1,478	1,558	1,629
Trust originated preferred securities (TOPrS)	1,000	990	-	-
Guaranteed obligations of employee stock ownership plans[1]	208	219	260	280

[1] See Note 10.

The fair values of SBC's long-term debt were estimated based on quoted market prices, where available, or on the net present value method of expected future cash flows using current interest rates. The fair value of the TOPrS was estimated based on quoted market prices. The carrying amounts of commercial paper debt approximate fair values.

SBC does not hold or issue any financial instruments for trading purposes. SBC's cash equivalents and short-term investments are recorded at amortized cost. The carrying amounts of cash and cash equivalents and short-term investments and customer deposits approximate fair values.

Pacific Telesis Financing I and II (the Trusts) were formed for the exclusive purpose of issuing preferred and common securities representing undivided beneficial interests in the Trusts and investing the proceeds from the sales of TOPrS in unsecured subordinated debt securities of PAC. Under certain circumstances, dividends on TOPrS could be deferred for up to a period of five years. TOPrS are subject to a limited guarantee from PAC. PAC sold $1 billion of TOPrS, $500 at 7.56% in January 1996 through Pacific Telesis Financing I and $500 at 8.5% in June 1996 through Pacific Telesis Financing II. Both issues of TOPrS were priced at $25 per share, have an original 30-year maturity that may be extended up to 49 years, and are callable five years after date of sale at par and are included on the balance sheet as corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts. The proceeds were used to retire short-term indebtedness, primarily commercial paper.

As of December 31, 1996, Pacific Telesis Financing I and II held subordinated debt securities of PAC in principal amounts of $515.5 and $514.5, respectively, with interest rates of 7.56% and 8.5%, respectively.

PAC has entered into an equity swap contract to hedge exposure to risk of market changes related to its recorded liability for outstanding employee stock options for common stock of AirTouch Communications, Inc. (spun-off operations) and associated SARs. (See Note 11) PAC plans to make open market purchases of the stock of spun-off operations to satisfy its obligation for options that are exercised. Off-balance-sheet risk exists to the extent the market price of the stock of spun-off operations rises above the market price reflected in the liability's current carrying value. The equity swap was entered into to hedge this exposure and minimize the impact of market fluctuations. The contract entitles PAC to receive settlement payments to the extent the price of the common stock of spun-off operations rises above the notional value of $23.74 per share, but imposes an obligation to make payments to the extent the price declines below this level. The swap also obligates PAC to make a monthly payment of a fee based on LIBOR. The total notional amount of the contract, $60 and $77 as of December 31, 1996 and 1995 respectively, covers the approximate number of the options and SARs outstanding of spun-off operations on that date. PAC plans to periodically adjust downward the outstanding notional amount as the options and SARs are exercised. The equity swap contract expires April 1999.

Both the equity swap and PAC's liability for the stock options and SARs of spun-off operations are carried in the balance sheet at their market values, which were immaterial as of December 31, 1996 and 1995. Gains and losses from quarterly market adjustments of the carrying amounts are substantially offset in results of operations. As of December 31, 1996 and 1995, the accounting loss that would be incurred from nonperformance by the counterparty to the equity swap was $4 and $14, respectively. However, management does not expect to realize any loss from counterparty nonperformance.

Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

8. Income Taxes

Significant components of SBC's deferred tax liabilities and assets are as follows at December 31:

	1996	1995
Depreciation and amortization	$ 3,283	$ 3,072
Other	1,019	820
Deferred tax liabilities	4,302	3,892
Employee benefits	2,221	2,206
Unamortized investment tax credits	195	224
Other	1,328	1,503
Deferred tax assets	3,744	3,933
Deferred tax assets valuation allowance	96	110
Net deferred tax liabilities	$ 654	$ 69

In 1996 the State of California reduced the corporate tax rate from 9.3% to 8.84%, effective for taxable years beginning on or after January 1, 1997. In accordance with generally accepted accounting principles, net deferred tax assets at December 31, 1996 were revalued to reflect the lower tax rate. This revaluation increasing state income tax expense, net of federal income tax, and decreasing net income was not material in 1996.

The decrease in the valuation allowance is the result of an evaluation of the uncertainty associated with the realization of certain deferred tax assets. The valuation allowance is maintained in deferred tax assets for certain unused federal and state loss carryforwards.

The components of income tax expense are as follows:

	1996	1995	1994
Federal			
Current	$ 1,242	$ 829	$ 1,347
Deferred--net	468	520	(49)
Amortization of investment tax credits	(80)	(95)	(124)
	1,630	1,254	1,174
State and local			
Current	172	176	245
Deferred--net	158	89	29
	330	265	274
Total	$ 1,960	$ 1,519	$ 1,448

Dollars in millions except per share amounts

A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate (35%) to income before income taxes and extraordinary loss is as follows:

	1996	1995	1994
Taxes computed at federal statutory rate	$ 1,802	$ 1,567	$ 1,479
Increases (decreases) in income taxes resulting from:			
Amortization of investment tax credits over the life of the plant that gave rise to the credits--1996 and 1995, net of deferred income tax	(53)	(92)	(124)
Excess deferred income taxes due to rate change	-	(24)	(35)
Depreciation of telephone plant construction costs previously deducted for tax purposes--net	-	14	23
State and local income taxes--net of federal income tax benefit	215	172	178
Other--net	(4)	(118)	(73)
Total	$ 1,960	$ 1,519	$ 1,448

9. Employee Benefits

Pensions - Substantially all employees of SBC are covered by one of three noncontributory pension and death benefit plans. The pension benefit formula used in the determination of pension cost for nonmanagement employees is based on a flat dollar amount per year of service according to job classification. For PAC managers, benefits accrue in separate account balances based on a fixed percentage of each employee's monthly salary with interest. For all other managers, employees' benefits are determined based upon a stated percentage of adjusted career income.

SBC's objective in funding the plans, in combination with the standards of the Employee Retirement Income Security Act of 1974 (as amended), is to accumulate funds sufficient to meet its benefit obligations to employees upon their retirement. Contributions to the plans are made to a trust for the benefit of plan participants. Plan assets consist primarily of stocks, U.S. government and domestic corporate bonds, index funds and real estate.

SBC reports pension costs and related obligations under the provisions of FAS 87 and FAS 88. However, prior to discontinuing application of FAS 71 during 1995, PacBell recognized pension costs consistent with the methods adopted for ratemaking. Nevada Bell continues to follow the accounting method prescribed by the Public Service Commission of Nevada. Pension costs recognized by PacBell under FAS 71 reflected a California Public Utilities Commission (CPUC) order requiring the continued use of the aggregate cost method for intrastate operations and a Federal Communications Commission (FCC) requirement to use FAS 87 and FAS 88 for interstate operations. (See Note 2)

Net pension cost is composed of the following:

	1996	1995	1994
Service cost--benefits earned during the period	$ 297	$ 311	$ 354
Interest cost on projected benefit obligation	1,131	1,161	1,142
Actual return on plan assets	(2,919)	(4,232)	(24)
Other--net	1,270	2,813	(1,396)
Net periodic pension cost (benefit) under FAS 87	(221)	53	76
Adjustment to reflect differing regulatory treatment	-	-	18
Net pension cost (benefit)	$ (221)	$ 53	$ 94

Notes to Consolidated Financial Statements, continued

Dollars in millions except per share amounts

The following table sets forth the pension plans' funded status and the amounts included in SBC's Consolidated Balance Sheets at December 31:

	1996	1995
Fair value of plan assets	$ 20,738	$ 20,019
Less: Actuarial present value of projected benefit obligation	15,006	17,339
Plan assets in excess of projected benefit obligation	5,732	2,680
Unrecognized prior service cost	845	992
Unrecognized net gain	(6,072)	(3,272)
Unamortized transition asset	(973)	(1,099)
Accrued pension cost	$ (468)	$ (699)

The projected benefit obligation was increased $202 and $407 at December 31, 1996 and 1995, respectively, for the cost of force reductions anticipated to take place in 1996 and 1997 and recognized in the SBC's financial statements under FAS 88.

Significant weighted average assumptions used in developing pension information include:

	1996	1995	1994
Discount rate for determining projected benefit obligation	7.5%	7.25%	7.78%
Long-term rate of return on plan assets	8.55%	8.0%	8.0%
Composite rate of compensation increase	4.3%	4.3%	4.3%

The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to previously rendered employee service. It is measured based on assumptions concerning future interest rates and employee compensation levels. Should actual experience differ from the actuarial assumptions, the benefit obligation will be affected.

In March 1996, management amended the pension plan for PAC managers from a final pay plan to a cash balance plan effective July 1, 1996. An enhanced transition benefit, based on frozen pay and service as of June 30, 1996 was established to preserve benefits already accrued by salaried employees under the final pay plan and resulted in an increase in earned benefits for most employees. SBC also updated the actuarial assumptions used in valuing the PAC plans to reflect changes in market interest rates and recent experience, including a change in its assumption concerning future ad hoc increases in pension benefits. Taken together, these changes increased net income by approximately $125 during 1996.

The actuarial estimate of the accumulated benefit obligation does not include assumptions about future compensation levels. The accumulated benefit obligation as of December 31, 1996 was $13,965, of which $12,376 was vested. At December 31, 1995 these amounts were $15,433 and $13,565. The reduction in the accumulated benefit obligation in 1996 reflects the changes noted above.

During 1996, 1995 and 1994, special pension benefits and cash incentives were offered in connection with PacBell restructuring and related force reduction program. Approximately 4,200, 2,200 and 3,800 employees left PacBell during 1996, 1995 and 1994, respectively, under retirement or voluntary and involuntary severance programs. Annual pension cost excludes $(64), $219 and $62 of additional pension costs charged to PacBell's restructuring reserve in 1996, 1995 and 1994, respectively.

In December 1996, under the provisions of Section 420 of the Internal Revenue Code, SBC transferred $73 in pension assets to a health care benefit account for the reimbursement of retiree health care benefits paid by SBC.

Dollars in millions except per share amounts

Supplemental Retirement Plans - SBC also provides senior and middle management employees with nonqualified, unfunded supplemental retirement and savings plans. These plans include supplemental defined pension benefits as well as compensation deferral plans, some of which include a corresponding match by SBC based on a percentage of the compensation deferral. Expenses related to these plans were $88, $91 and $94 in 1996, 1995 and 1994. Liabilities of $758 and $701 related to these plans have been included in other noncurrent liabilities in SBC's Consolidated Balance Sheets at December 31, 1996 and 1995.

Postretirement Benefits - SBC provides certain medical, dental and life insurance benefits to substantially all retired employees under various plans and accrues actuarially determined postretirement benefit costs as active employees earn these benefits. However, employees retiring after certain dates will pay a share of the costs of medical coverage that exceeds a defined dollar medical cap. Such future cost sharing provisions have been reflected in determining SBC's postretirement benefit costs.

Postretirement benefit cost is composed of the following:

	1996	1995	1994
Service cost--benefits earned during the period	$ 101	99	$ 108
Interest cost on accumulated postretirement benefit obligation (APBO)	475	496	489
Actual return on assets	(375)	(452)	(19)
Other--net	208	318	(87)
Postretirement benefit cost	$ 409	$ 461	$ 491

SBC maintains Voluntary Employee Beneficiary Association (VEBA) trusts to fund postretirement benefits. During 1996 and 1995, SBC contributed $320 and $455 into the VEBA trusts to be ultimately used for the payment of postretirement benefits. Assets consist principally of stocks and U.S. government and corporate bonds.

The following table sets forth the plans' funded status and the amount included in SBC's Consolidated Balance Sheets at December 31:

	1996	1995
Retirees	$ 4,047	$ 4,200
Fully eligible active plan participants	706	583
Other active plan participants	1,819	1,867
Total APBO	6,572	6,650
Less: Fair value of plan assets	2,697	2,169
APBO in excess of plan assets	3,875	4,481
Unrecognized prior service cost	(31)	(38)
Unrecognized net gain	1,119	616
Accrued postretirement benefit obligation	$ 4,963	$ 5,059

In December 1995, one of the life insurance benefit plans was merged with one of the medical plans. Also in December 1995, $109 of postretirement life insurance assets were transferred to the VEBA trusts. The fair value of plan assets restricted to the payment of life insurance benefits only were $746 and $700 at December 31, 1996 and 1995. At December 31, 1996 and 1995, the accrued life insurance benefits included in the accrued postretirement benefit obligation were $57 and $42.

The assumed medical cost trend rate in 1997 is 8%, decreasing gradually to 5.5% in 2002, prior to adjustment for cost-sharing provisions of the plan for active and certain recently retired employees. The assumed dental cost trend rate in 1997 is 6.25%, reducing to 5.0% in 2002. Raising the annual medical and dental cost trend rates by one percentage point increases the APBO as of December 31, 1996 by $557 and for 1996 by approximately $53. Significant assumptions for the discount rate, long-term rate of return on plan assets and composite rate of compensation increase used in developing the APBO and related postretirement benefit costs were the same as those used in developing the pension information.

Dollars in millions except per share amounts

10. Other Employee Benefits

Employee Stock Ownership Plans - SBC maintains contributory savings plans which cover substantially all employees. Under the savings plans, SBC matches a stated percentage of eligible employee contributions, subject to a specified ceiling.

SBC has three leveraged Employee Stock Ownership Plans (ESOPs) as part of the existing savings plans. Two of the ESOPs were funded with notes issued by the savings plans to various lenders, the proceeds of which were used to purchase shares of SBC's common stock in the open market. These notes are unconditionally guaranteed by SBC and therefore recorded as a liability. They will be repaid with SBC contributions to the savings plans, dividends paid on SBC shares and interest earned on funds held by the ESOPs.

The third ESOP purchased PAC treasury shares in exchange for a promissory note from the plan to PAC. Since PAC is the lender, this note is not reflected as a liability and the remaining cost of unallocated trust shares is carried as a reduction of shareowners' equity. Principal and interest on the note is paid from employer contributions and dividends received by the trust. All PAC shares were exchanged for SBC shares effective with the merger April 1, 1997. The provisions of this ESOP were unaffected by this exchange.

SBC's match of employee contributions to the savings plans is fulfilled with shares of stock allocated from the ESOPs and with purchases of SBC's stock in the open market. Shares held by the ESOPs are released for allocation to the accounts of employees as employer matching contributions are earned. Benefit cost is based on a combination of the contributions to the savings plans and the cost of shares allocated to participating employees' accounts. Both benefit cost and interest expense on the notes are reduced by dividends on SBC's shares held by the ESOPs and interest earned on the ESOPs' funds.

Information related to the ESOPs and the savings plans is summarized below:

	1996	1995	1994
Benefit expense--net of dividends and interest income	**$ 65**	$ 66	$ 67
Interest expense--net of dividends and interest income	**26**	37	36
Net ESOP expense	**91**	103	103
Additional savings plans stock purchases	**-**	-	(1)
Total expense	**$ 91**	$ 103	$ 102
Company contributions for ESOPs	**$ 108**	$ 89	$ 118
Dividends and interest income for debt service	**$ 62**	$ 72	$ 62

SBC shares held by the ESOPs are summarized as follows at December 31:

	1996	1995
Unallocated	**15,502,896**	16,136,159
Committed to be allocated	**177,594**	274,425
Allocated to participants	**15,559,574**	16,209,602
Total	**31,240,064**	32,620,186